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Nos. 23 and 24

In the Supreme Court of the United States

OCTOBER TERM, 1939

THOMAS K. CASE AND ADELE B. COWAN, AND ESTATE OF ADELE B. COWAN, DECEASED, PETITIONERS

v.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.

THOMAS K. CASE AND ADELE B. COWAN, AND ESTATE OF ADELE B. COWAN, DECEASED, PETITIONERS

v.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES AMICUS CURIAE

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OPINIONS BELOW

The District Court filed two opinions. The first, filed May 10, 1938, is not reported but appears in the record at p. 156. The second, filed August 6, 1938, is reported in 24 F. Supp. 501 and appears in the record at p. 202. The opinion of the Circuit

Court of Appeals is reported in 100 F. (2d) 963 and appears in the record at p. 372.

JURISDICTION

The interlocutory order of the District Court confirming the plan of reorganization was filed May 12, 1938 (R. 129). The final order of the District Court confirming the plan was filed July 19, 1938 (R. 306). The decrees of the Circuit Court of Appeals affirming the decrees of the District Court were filed January 12, 1939 (R. 381, 382), and the order of the Circuit Court of Appeals denying the petition for rehearing was filed February 9, 1939 (R. 383). Petition for certiorari was filed in this Court March 28, 1939, and was granted May 22, 1939 (R. 385). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

STATUTES INVOLVED

The statutory provisions involved are contained in Section 77B of the Bankruptcy Act (11 U. S. C. 207). The pertinent provisions are set forth in Appendix B, *infra*, pp. 57–74.

QUESTIONS PRESENTED[1]

1. Whether the requirement of Section 77B of the Bankruptcy Act that a plan of reorganization be

[1] Petitioners' arguments with respect to the power of a court under Section 77B to impair the lien of a secured creditor, or

"fair and equitable" necessitates completely compensatory treatment for senior securities before junior securities may participate in the reorganized enterprise.

2. Whether the "consideration" furnished by the stockholders in this case constitutes, as a matter of law, a contribution adequate to justify their participation under the reorganization plan.

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the power of a majority of a class of creditors to bind the minority of that class by their consent to a plan of reorganization, will not be discussed in this brief. So far as these issues presented a question of constitutionality they were decided against petitioners by the District Court (R. 210–218). Petitioners did not question the constitutionality of Section 77B in the Circuit Court of Appeals (R. 380), and in these circumstances there is no occasion for this Court to consider the question. *Duignan* v. *United States*, 274 U. S. 195, 200. The case was not certified to the Attorney General by either of the lower courts as is required when cases involve the constitutionality of an Act of Congress (Act of August 24, 1937, 50 Stat. 75; 28 U. S. C. 401).

In any event, these contentions of petitioners present no substantial questions of statutory construction or of constitutionality in view of the decisions of this Court in *Continental Illinois National Bank and Trust Co.* v. *Chicago, Rock Island & Pacific Railway Co.*, 294 U. S. 648, and *Canada Southern Railway Co.* v. *Gebhardt*, 109 U. S. 527. The constitutionality of the powers conferred on the courts in these respects by Section 77B has been upheld in the following cases, among others, decided by the Circuit Courts of Appeals: *Campbell* v. *Alleghany Corp.*, 75 F. (2d) 947 (C. C. A. 4th), certiorari denied, 296 U. S. 581; *Humphrey* v. *Bankers Mortgage Co.*, 79 F. (2d) 345 (C. C. A. 8th); *Grand Blvd. Investment Co.* v. *Strauss*, 78 F. (2d) 180 (C. C. A. 8th).

STATEMENT

NATURE OF THE PROCEEDINGS

This is a voluntary proceeding for reorganization under Section 77B of the Bankruptcy Act, instituted by the respondent, Los Angeles Lumber Products Company, Ltd., a California corporation (referred to in this brief as the Debtor).

FINANCIAL BACKGROUND OF THE DEBTOR

The Debtor is a holding company. Its only important asset is all the capital stock of a shipbuilding corporation (R. 28, 316). It has outstanding $2,565,500 in bonds, secured by a mortgage on the property of the shipbuilding corporation and a pledge of all the shipbuilding corporation's stock (R. 5–6). The total indebtedness on the bonds, including accrued interest, aggregates $3,807,071 (R. 70, 319).[2] The Debtor also has outstanding 57,788 shares of Class A stock and 5,112 shares of Class B stock (R. 6, 319).

The shipbuilding corporation owns a shipbuilding and ship repairing plant located on leased land at San Pedro, California (R. 29). During recent years the plant has been used for repair work (R. 71). Small operating profits, before depreciation, have been earned, but these have been insufficient to meet current interest on the Debtor's bonds (R. 29).

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[2] Record references to pages 63 to 118 refer to findings in the Master's report, which (with exceptions irrelevant here) were adopted as findings of the District Court (R. 135, 313).

No interest has been paid on the bonds since 1929 (R. 70, 319). In 1930, with the consent of a majority of the bondholders, the trust indenture under which the bonds were issued was amended, pursuant to a provision therein, to provide for a waiver of the existing defaults in interest, and to reduce the interest from a fixed rate of 7½% per annum to a rate of 6% per annum if earned. The interest coupons were made unenforceable until the principal of the issue matured in 1944 (R. 74–76, 321).

The present Class A and Class B stock of the Debtor was issued in connection with this voluntary adjustment in 1930. The existing stock was wiped out by an assessment, and the new Class A stock was issued to stockholders who paid in $400,000 (R. 75, 320). The Class B stock was issued to bondholders who were willing to accept it in payment of defaulted interest (R. 76).

The physical plant of the shipbuilding corporation was appraised in 1936 at $465,000 as a going concern (R. 9, 31). At the time of the institution of the reorganization proceeding there were current assets of approximately $365,000, thus giving a total value to the enterprise for reorganization purposes, as found by the District Court, of approximately $830,000 (R. 31, 316). This amount, of course, is far less than the aggregate of $3,807,071 of principal and accrued interest on the first mortgage bonds. The District Court found the

Debtor to be insolvent in both the bankruptcy and the equity sense (R. 140, 319).

THE PLAN OF REORGANIZATION

Despite the insolvency of the Debtor, the plan, which was confirmed as "fair and equitable" under the statute, contemplates the participation in the reorganized company not only of the bondholders but also of the holders of the Class A stock (R. 25, 58, 345).

In brief, it provides for the creation of a new corporation with a capital structure of 1,000,000 shares of authorized $1 par value voting stock. The stock is divided into 811,375 shares of preferred stock and 188,625 shares of common stock.[3]

In exchange for their bonds, the bondholders will receive 641,375 shares of the preferred stock.[4] This is on the basis of 250 shares for each $1,000 bond and accrued interest. The Class A stockholders will receive 188,625 shares of common stock (R. 344–345).

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[3] The preferred stock will be entitled to a 5% noncumulative dividend, after which the common stock is to receive a similar dividend. Thereafter both classes share equally in the dividends. On liquidation the preferred receives a preference to the extent of its par value, then the common receives a similar preference, and thereafter both classes share equally.

[4] The balance of 170,000 shares of preferred stock is reserved for sale in order to raise funds for the rehabilitation of the plant, although beyond this the plan contains no suggestion as to how the funds are to be raised (R. 26).

The par value of the total proposed issue of preferred and common stock to existing security holders will equal the estimated going concern value of the assets of the enterprise. Accordingly, in return for a claim to principal and interest aggregating $3,807,071, the bondholders will receive but 77% of the assets of the enterprise, represented by securities having a par value, asset value, and liquidating preference of only $641,375. The remaining 23% will go to the Class A stockholders.

The plan was assented to by holders of approximately 92.81% in amount of the outstanding bonds, 99.75% of the Class A common stock, and 90% of the Class B common stock (R. 210, 327). The petitioners are dissenting bondholders owning $18,500 face value of the bonds (R. 247, 256).

DISPOSITION OF THE PLAN IN THE LOWER COURTS

In approving the plan as "fair and equitable" under the statute, the District Court justified the participation in the reorganized company allotted to the Class A stockholders primarily on the ground that they had furnished a "consideration" warranting the issuance of the new stock to them. This conclusion was based partly on the theory that, as a result of the reorganization, the Class A stockholders would abrogate the 1930 agreement, in so far as it had the effect of deferring any foreclosure proceedings until 1944, when the principal of the bonds was to mature. It was also based on a finding that the retention of the present Class

A stockholders as stockholders would be an asset of value to the new company because of their familiarity with the business, and because of their financial standing and influence in the community (R. 321–323).

In affirming the action of the District Court the Circuit Court of Appeals took the position that it could not look behind the trial court's conclusion that the plan was "fair and equitable," because of a stipulation by the petitioners that "they intend to raise questions of substantive law only; that they will not attack the findings of the trial court on the ground that they are unsupported by evidence * * *" (R. 285). Hitherto, however, the courts have regarded the fairness and equity of a plan of reorganization as a question of law.[5] Moreover, among the points reserved for appeal in the stipulation were Point 2, which alleges that the trial court erred in allowing the stockholders of the insolvent corporation to participate in the plan, and Point 6, which alleges that the plan is "neither

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[5] Appeals from orders confirming plans under Section 77B had to be taken under Sec. 24 (b) of the Bankruptcy Act, *Meyer* v. *Kenmore Granville Hotel Co.*, 297 U. S. 160, and prior to the amendments of 1938 were restricted to the review of questions of law. Bankruptcy Act, Section 24 (b), 11 U. S. C. 47 (b) (prior to 1938 amendments); *Price* v. *Spokane Silver & Lead Co.*, 97 F. (2d) 237 (C. C. A. 8th, certiorari denied, 305 U. S. 626); *Texas Hotel Securities Corp.* v. *Waco Development Co.*, 87 F. (2d) 395 (C. C. A. 5th). The various circuit courts of appeals have, on review under Sec. 24 (b), examined the fairness and equity of the reorganization plans involved in such appeals from

fair, equitable, nor feasible" (R. 286). It would appear, therefore, that the parties themselves have reserved the question of fairness and equity as a question for determination on appeal.

STATEMENT OF INTEREST OF THE UNITED STATES

Neither the United States nor any agency thereof is a party to this case, or immediately interested in its outcome. However, the case involves the interpretation of a statutory standard of vital importance in the reorganization of corporations—the standard by which plans of reorganization effected under the laws of the United States are to be found "fair and equitable." This brief is filed by the United States as *amicus curiae* in order to urge upon the Court the importance of a definitive judicial interpretation of that standard, and to assist the Court in arriving at such an interpretation.

(1) *The interest of the United States and its agencies in the legal issues*

In their administration of laws relating to corporate reorganizations, agencies of the United

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orders of confirmation. *Downtown Investment Ass'n* v. *Boston Metropolitan Bldgs.*, 81 F. (2d) 314 (C. C. A. 1st); *In re Barclay Park Corp.*, 90 F. (2d) 595 (C. C. A. 2d); *Price* v. *Spokane Silver & Lead Co.*, 97 F. (2d) 237 (C. C. A. 8th, certiorari denied, 305 U. S. 626). (In these last two cases orders confirming plans were reversed because the plans were not fair and equitable.) If the fairness of the plan is a question of law, the parties cannot, of course, foreclose the Court's consideration of the question by stipulation. *Swift & Co.* v. *Hocking Valley Ry. Co.*, 243 U. S. 281.

States, particularly the Interstate Commerce Commission and the Securities and Exchange Commission, are confronted, in a variety of situations, with the duty of determining whether plans of reorganization are fair and equitable.[9]

Under Section 77 of the Bankruptcy Act, 11 U. S. C. 205, which relates to railroads, no plan of reorganization may be approved by the district court unless the court finds, among other things, that the plan is fair and equitable, and unless the plan has been first approved by the Interstate Commerce Commission. There are now pending before that Commission 30 reorganization proceedings involving 61,600 miles of operated railroad.

Chapter X of the Bankruptcy Act, 11 U. S. C. 501–676, which today provides the mechanism for the reorganization of corporations other than railroads, also conditions judicial approval and confirmation of a plan of reorganization upon a finding that the plan is fair and equitable. By virtue of Section 208 of chapter X, 11 U. S. C. 608, the Securities and Exchange Commission participates in proceedings under that chapter, and is deemed a party in interest with a right to be heard on all matters arising in the proceeding. On October 1, 1939, that Commission was a party in over 100 cases under the Act. Furthermore, Section 172 of chapter X, 11 U. S. C. 572, imposes upon that Commission the duty of examining and reporting

[9] The text of the provisions of the statutes which impose these duties are set forth in Appendix B, *infra*, pp. 61, 66–74.

on plans of reorganization referred to it for that purpose by the district judge. It is therefore essential for the Commission, under chapter X, to interpret and apply the term "fair and equitable" to the plans which come before it for consideration and report.

Section 77B of the Bankruptcy Act (the predecessor of chapter X[1]), under which this case arose, did not provide for participation by the Securities and Exchange Commission. The requirement that plans be "fair and equitable" is present, however, in both statutes. Moreover, chapter X is applicable to reorganizations begun under Section 77B to the extent that the judge deems such application practicable (Section 276. c.). Accordingly, the Securities and Exchange Commission may be concerned with the fairness of plans of reorganization in proceedings begun before the enactment of chapter X, and is in fact now a party in a number of such cases.

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[1] Section 77B was amended by the Act of June 22, 1938, and incorporated into chapter X of the Bankruptcy Act. Under Section 276. c. (2) of the amendatory Act, 11 U. S. C. 676. c. (2), provisions of Section 77B continue to govern proceedings in which the petition was approved more than three months prior to the effective date of the amendatory Act, September 22, 1938, to the extent that the judge does not deem the application of chapter X "practicable." The standards governing the exercise of the district judge's discretion under Section 276. c. (2) are discussed in *In re Old Algiers, Inc.*, 100 F. (2d) 374 (C. C. A. 2d); *In re Philadelphia & Reading Coal & Iron Co., Appeals of Schrager*, 105 F. (2d) 354 (C. C. A. 3d). The petition in the present case was approved on January 28, 1938 (R. 63, 310).

Apart from bankruptcy legislation, the Securities and Exchange Commission is interested in the criteria of "fairness" applicable to plans of reorganization by virtue of Section 11 of the Public Utility Holding Company Act of 1935 (15 U. S. C. 79k), which in substance requires that no plan of reorganization for a registered holding company or subsidiary thereof in a court of the United States shall become effective unless such plan has been approved by the Commission.[8]

Thus both the Interstate Commerce Commission and the Securities and Exchange Commission are interested in an authoritative declaration of the principles governing the interpretation of the terms "fair and equitable," as used in statutes of the United States, not only as such interpretation may provide the guide to the proper recognition of the priority of senior interests over junior interests in reorganization, but also as it may define the limits of the right of stockholders or junior creditors to participate in the assets of reorganized companies on the basis of contributions of cash or its fair equivalent.

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[8] Subsection (f). In addition, subsection (g) makes it unlawful for any person to solicit, by use of the mails or any means or instrumentality of interstate commerce or otherwise, any proxy, consent, authorization, power of attorney, deposit or dissent in respect of any reorganization plan of a registered holding company or subsidiary company, unless the solicitation is accompanied or preceded by a copy of a report on the plan which shall be made by the Commission.

(2) The public interest in economic aspects of the doctrines involved

The interest of the United States is based upon considerations broader than may be apparent from the mere statement of the duties of its agencies. For that reason it is deemed appropriate before entering upon a detailed discussion of the legal issues to point out, against the illustrative facts of this case, the general effect of the doctrines to be discussed as they impinge upon the national economy. In our view the decision of this case should guide the proper disposition of thousands of corporate reorganization cases.* The manner of their disposition bears vitally on problems of general economic importance, involving both the protection of the rights of countless individual investors and the assurance of sound corporate finance.

This Court has several times declared that the condition of participation by junior interests in a

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*During the period June 7, 1934 (the effective date of Section 77B), through October 31, 1938, the following number of cases were instituted: 930 cases in 1934 (7 months); 1,830 cases in 1935; 955 cases in 1936; 980 cases in 1937; and 822 cases in 1938 (10 months). Hearings before the Subcommittee of the House Committee on Appropriations, 76th Cong., 1st Sess. (1938–1939), p. 375.

From September 22, 1938 (when chapter X, successor to Section 77B, became effective), to March 31, 1939, a total of 251 new cases were begun thereunder. S. E. C. Statistical Series, Release No. 249 (May 8, 1939).

reorganization plan is the prior satisfaction of all senior claims. This has been called the doctrine of "absolute priority." As we shall point out hereafter, no deviation from this principle of fairness has appeared in the decisions of this Court, and very little express deviation from it is apparent in decisions of the lower courts. However, while paying lip service to the rule, the lower courts have at times exhibited a tendency to sanction plans which circumvent the rule.[10] Their decisions lead, if not to denial of the doctrine, at least to its nullification.

Since the enactment of Sections 77 and 77B this tendency has been supported by an argument, to which various *dicta* lend themselves, that the doctrine of fairness laid down by this Court[11] has, by legislative fiat, been displaced by a so-called "composition" theory.[12] And the recognized corollary of the absolute priority doctrine—the rule that junior interests for whom no equity

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[10] A detailed analysis of these cases in equity reorganizations is contained in Foster, *Conflicting Ideals for Reorganization*, 44 Yale L. J. 923 (1935); Bonbright and Bergerman, *Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization*, 28 Col. L. Rev. 127 (1928); Note, *The "Fair" Plan in Corporate Reorganization*, 35 Col. L. Rev. 391, 549 (1935).

[11] *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482 and related cases discussed *infra*, p. 24 *et seq.*

[12] In the present case the District Court quoted approvingly another opinion which advanced this "composition" theory (R. 216–218). This is discussed *infra*, p. 29 *et seq.*

remains may nevertheless be allowed to participate if they are willing to contribute necessary money or money's worth to the reorganized company—has been perverted into a device for depriving senior interests of the property values which this Court has held them entitled to retain.

Intrinsically the case before the Court may not be of major importance. The corporate structure being reorganized is simple. The detrimental economic consequences which flow from a cumulative abuse of the reorganization system will not be greatly aggravated by the confirmation of this particular plan. But the very simplicity of the case lends it significance in the law of reorganization. Here, unobscured by complex detail, can be seen the devices by which stockholders, faced with the consequences of the risk-taking position which they have voluntarily assumed, have sought to invoke nebulous considerations and to bargain, sometimes successfully, with valueless rights against the real claims of the bondholders. We have, in short, a relatively simple example of typical methods by which junior interests have frequently succeeded in whittling down the principles established by this Court for the protection of senior interests.

The need for protection of contract rights is sharply outlined by the facts of this case. The plan allocates but 77% of the estimated going-concern value of the assets to the bondholders. In return the bondholders surrender approximately

three-quarters of the principal amount of their claim, accepting 641,375 shares of $1 par value preferred stock in satisfaction of claims aggregating $3,807,071. Moreover, they are displaced from their position as first lienors and become stockholders, so that a new bond issue may be given precedence to their claim. On the other hand, for "consideration" which we shall show to be without basis, the stockholders, who have no equity in the assets, are allotted 23% of the assets and voting power which, in all probability, will enable them to exercise control of the corporation (R. 96).

The effect upon investors of such unsettlement of contract rights hardly needs to be stressed. Senior security holders invest at low interest or fixed dividend rates, foregoing participation in any extraordinary profits of the enterprise in reliance on the greater assurance of safety provided by their contract. In sacrificing profit opportunities they rely, and on the assumption that those who have ventured their capital in the hope of speculative profits will bear the risks of the enterprise, and on the promise that in the event of financial reverses they will be made whole before provision is made for the risk-bearing junior interests. The ultimate measure of their rights is the treatment which their securities receive in reorganization.

In cases of liquidation no one questions the right of senior security holders to full payment before

any distribution of assets to junior interests. Reorganization is an alternative for liquidation in the event of financial failure. It seeks to substitute going concern values for the forced sale values of liquidation, with the object of yielding greater ultimate returns to the senior interests, and allowing wider participation if the values permit. But it presents no occasion or excuse for a different treatment of priorities in disregard of senior contract rights. The obligation of contract has an unreal quality if the terms of the undertaking are dealt with in practice as nothing more than "mere legal verbiage." [13]

The problem, however, bears not only upon the protection of individual investors, but also upon the soundness of reorganized capital structures. It is axiomatic that a successful reorganization requires a readjustment of capital structure to correspond to existing and reasonably estimated future earnings. A top-heavy structure of debt and fixed charges not only creates the danger of default but constitutes an obstacle to the financing of future capital needs through the sale of stock.[14] The history of railroad reorganizations demonstrates that further expansion of an already heavy bonded indebtedness left outstanding after reor-

[13] Dewing, Financial Policy of Corporations (3rd ed. 1934) 1157.

[14] The use of income bonds instead of fixed interest bonds does not cure the difficulty. The former represent a claim to earnings and asset values ahead of stock, and they have fixed

ganization contains the seed of recurrent insolvency.[15]

Yet fixed charges, top-heavy debts, and complicated structures have persisted in corporate reorganizations.[16] This has frequently been due to a failure properly to apply the absolute priority rule. Instead of eliminating valueless claims, a participation has been allotted to all existing security holders. In the attempt at the same time to preserve the priorities of senior security holders, a

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maturities. The presence of substantial issues of stock which no longer reflect asset values but which nevertheless represent a claim to improved earnings likewise restricts the possibility of new stock financing.

[15] *Reorganization Plans as Causes of Recurrent Insolvencies*, Report of the Senate Committee on Interstate Commerce, No. 25, Part 1, 76th Cong., 1st Sess. (1939), p. 2. Approximately 31% of the railroad mileage of this country is being operated by court receivers and trustees and many of the roads thus involved had not long emerged from earlier receiverships: Chicago, Milwaukee & St. Paul (1928), Denver & Rio Grande Western (1923), Chicago & Eastern Illinois (1921), Missouri Pacific (1917), Western Pacific (1915–16), Wabash (1915). Spaeth and Windle, *Valuation of Railroads Under Section 77 of the Bankruptcy Act*, 32 Ill. L. Rev. 517–8 (1938). An exhaustive tabulation of railroad reorganizations by periods, disclosing the recurring appearance of the same roads, is found in Hearings of the Senate Committee on Interstate Commerce on S. 1869, 76th Cong., 1st Sess., p. 36 *et seq.*

[16] An outstanding example of the stratification of security structures in reorganizations is to be found in the 1928

necessary corollary has been that new debts, interest charges, and preferred stocks have been created. Frequently companies have emerged from reorganization with more burdensome debt charges and more complicated capital structures than they had at the beginning of the proceedings. The usual result is an early return to the reorganization fold.

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reorganization of the Chicago, Milwaukee & St. Paul Railroad. All classes of existing security holders were permitted to participate, in part on the basis of a cash contribution by preferred and common stockholders. New securities in the form of bonds, preferred stocks, and common stocks were issued. Interest charges under the plan exceeded the interest charges prior to the receivership. See *Jameson* v. *Guaranty Trust Co.*, 20 F. (2d) 808 (C. C. A. 7th), certiorari denied, 275 U. S. 569; *Chicago, Milwaukee & St. Paul Reorganization*, 131 I. C. C. 673. The railroad returned to reorganization in less than ten years. U. S. District Court, Northern District Illinois, Index No. 60463 (1935).

The plan in the above case has been rationalized in terms of a so-called doctrine of relative priority. See Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade*, 27 Col. L. Rev. 901 (1927); *Bonbright and Bergerman, Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization*, 28 Col. L. Rev. 127 (1928).

In 29 reorganizations of industrial corporations between 1921 and 1929, studied after 1929, fixed charges were increased in 13, remained stationary in 4 and decreased in but 12 cases. *Dewing, Financial Policy of Corporations* (3d ed. 1934), 1246. Only 15 out of 31 Class I railroad reorganizations effected through court proceedings between 1915 and 1933 met a suggested test that fixed charges should not exceed 80% of average earnings for the worst 3 years of the preceding ten (99 Railway Age, 433–434 (1935)).

Economic disadvantages also flow from the issuance of valueless securities in reorganization, securities which reflect neither existing value nor the payment of a fresh contribution by junior interests. It is patently undesirable to place upon the market securities which represent little more than the paper upon which they are written. Such valueless securities create the risk of fraud upon future purchasers, and are peculiarly susceptible to use as media for market manipulations.[17] Commenting on such securities, the Chairman of the Senate Committee on Interstate Commerce has said:

> where you have this large amount of stock without any earning capacity at all, it is just used as a speculative football, to be traded in, and also for the control of the railroad itself.[18]

No less objectionable, from the standpoint both of investors and of the general public interest, is

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[17] The New York Stock Exchange in several cases has asked the Securities and Exchange Commission for permission to strike issues of appreciably reduced asset value from listing and registration on the ground that such issues were particularly vulnerable to manipulation. *Standard Investing Corp.*, S. E. C. Securities Exchange Act Release No. 2046; *Minneapolis, St. Paul & Sault Ste. Marie Ry. Co.*, S. E. C. Securities Exchange Act Release No. 2059.

[18] The stock referred to was that of the Seaboard Air Line Railway, which emerged from receivership some thirty years ago. The stock has never paid a dividend but has been persistently traded in large volume. Hearings on S. 1869, 76th Cong., 1st Sess., p. 449.

the fact that the reorganization machinery permits the holders of valueless interests to perpetuate themselves in control. Although a common stock interest allotted to the old stockholders may be valueless in terms of market or asset value, ordinarily it carries voting control.[19] With voting control the old stockholders may avail themselves of emoluments and indirect benefits which are vastly more valuable than mere dividend possibilities or potentialities of market value. Not only is it patently inequitable to allow the holders of a valueless equity to retain so valuable an interest in the corporation, but it is a commonplace of corporate finance that the perpetuation of controlling common stock interests without asset value invites manipulation of corporate enterprises for the profit of the controlling interests and to the detriment of the corporation itself.[20]

Attempts are encouraged to create asset value by speculative schemes, or by reinvestment of profits in the enterprise at the expense of holders of noncumulative income bonds or preferred stock.[21] If

[19] Moore, *Railroad Fixed Charges in Bankruptcy Proceedings*, 47 J. Pol. Econ. 100, 115, 118 (1939).

[20] An extended study of the benefits of control to such controlling stock interests is contained in Berle and Means, *The Modern Corporation and Private Property* (1932) 153–219. Pertinent also is Commissioner Eastman's testimony in Hearings before the House Committee on the Judiciary on H. R. 6249, 74th Cong., 1st Sess., pp. 282–283.

[21] Dewing, *The Position of Income Bonds as Illustrated by Those of the Central of Georgia Railroad*, 25 Quart. Jour.

contingent charges are cumulative, the controlling equity interests, spurred by hopes of resumed dividends, may be driven to unwise attempts to increase earnings at the expense of adequate property maintenance in order to forestall accumulation of prior charges. If the enterprise is affected with a public interest the public is directly concerned with threatened impairment of service. Even in the case of a wholly private enterprise persistent skimping on maintenance inevitably leads back to reorganization.

Finally, we direct the attention of the Court to the stimulus which uncertainty as to relative rights gives to obstructionist tactics. If the basis for the treatment of contract rights is unsettled, reorganization ceases to be an orderly process of allocating assets in accordance with priorities. Instead it becomes a process of haggling, in which endurance challenges legal position." Junior security holders trade on their nuisance value in order to enforce levies upon the assets. Especially where senior securities are widely dispersed and the valueless equity securities are compactly held by a group or corporation, the threat of protracted litigation

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Econ. 396. An example of the employment of this technique for a similar purpose appears in *MacIntosh* v. *Flint & Pere Marquette R. Co.*, 34 Fed. 582 (C. C. E. D. Mich.).

[11] Spaeth and Windle, *Valuation of Railroads under Section 77 of the Bankruptcy Act*, 32 Ill. L. Rev. 517, 519 (1938).

often becomes an important factor in the formulation of the plan."

We believe, therefore, that these considerations make it evident that this Court should reaffirm the doctrine of absolute priority as applicable to proceedings under the reorganization statutes and foreclose further resort to devices which may be used to nullify its effectiveness.

SUMMARY OF ARGUMENT

The applicable statutory provisions of Section 77B require, as a condition of confirmation of a plan of reorganization, that the court find the plan "fair and equitable." Compliance with the same standard was required in reorganizations effected in equity receiverships, and this Court's decisions in such cases are controlling in reorganizations under Section 77B, as a matter both of statutory construction and judicial interpretation.

A plan of reorganization which fails to give precedence to the entire claim of senior creditors before permitting participation by junior creditors

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[11] The Senate Committee on Interstate Commerce has described the opposition of the Pennsylvania Company and Alleghany Corporation, largest common stockholders of subsidiaries in reorganization (Wabash and Missouri, Pacific Ry., respectively), to the exclusion of valueless junior interests, as leading to reorganizations which would be "mere preludes to repeated bankruptcies". Report No. 25, Part I, 76th Cong., 1st Sess., pp. 18–25. The present case, in which the bonds are publicly held while the Class A stock is closely held, furnishes an apt example. The District Court found that the willingness of the stockholders to forego litigation constituted valuable consideration (R. 323).

or stockholders is not fair and equitable as a matter of law. Such a plan cannot be made valid by the consent of the percentage of a class of security holders required for confirmation of a plan. The plan in the present case fails to give precedence to the claim of the bondholders, and therefore fails to comply with the statutory standard.

The alleged "consideration" proposed to be furnished by the stockholders under the plan fails to meet the conditions upon which the allotment of a participation to the holders of valueless interests, on the basis of a contribution by them, may properly be justified. Therefore, it does not remedy the failure of the plan to comply with the statutory requirements of fairness.

ARGUMENT

I

A PLAN OF REORGANIZATION WHICH FAILS TO GIVE PRECEDENCE TO THE ENTIRE CLAIM OF SENIOR CREDITORS BEFORE PERMITTING PARTICIPATION BY JUNIOR CREDITORS OR STOCKHOLDERS IS NOT FAIR AND EQUITABLE AS A MATTER OF LAW

The standard of fairness which is controlling in this case is derived from *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482, and related cases.[24] That standard, known as the "absolute priority" rule, requires that a plan, to be fair, must pro-

[24] *Railroad Co.* v. *Howard*, 7 Wall. 392; *Louisville Trust Co.* v. *Louisville, Albany & Chicago Ry. Co.*, 174 U. S. 674 (the "Monon" case); *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445.

vide recognition approximating full payment for claims in the order of their priority. As stated by this Court in a later case, a plan of reorganization "which does not give precedence to *the entire claim* of the creditors over any part or interest of a stockholder" is not "sufficient as to unsecured creditors and binding upon them * * *." *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445, 452, 455. (Italics supplied.) The same principle is applicable to the claims of senior creditors as against junior creditors and stockholders.[25]

This is the doctrine of the *Boyd* case as applied by most courts[26] and understood by most legal writers.[27]

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[25] We believe it unnecessary to undertake any elaborate exposition of the cases in which this Court has discussed this principle. For the convenience of the Court we have set out several extracts from the leading cases in Appendix A, *infra*, pp. 51–56.

[26] *In re 620 Church St. Bldg. Corp.*, 299 U. S. 24; *In re Witherbee Court Corp.*, 88 F. (2d) 251 (C. C. A. 2d), cert. den., 301 U. S. 701; *In re Barclay Park Corp.*, 90 F. (2d) 595 (C. C. A. 2d); *In re Day & Meyer, Murray & Young, Inc.*, 93 F. (2d) 657 (C. C. A. 2d); *In re Philadelphia & Reading Coal & Iron Co., Appeal of Schrager* (C. C. A. 3d) 105 F. (2d) 357; *Price* v. *Spokane Silver & Lead Co.*, 97 F. (2d) 237 (C. C. A. 8th), cert. den., 305 U. S. 626 (1938); *Sophian* v. *Congress Realty Co.*, 98 F. (2d) 499 (C. C. A. 8th); *Tellier* v. *Franks Laundry Co.*, 101 F. (2d) 561 (C. C. A. 8th); *In re Dutch Woodcraft Shops*, 14 F. Supp. 467 (W. D. Mich.).

[27] Spaeth and Winks, *The Boyd Case and Section 77*, 32 Ill. L. Rev. 769 (1938); Foster, *Conflicting Ideals for Reorganization*, 44 Yale L. J. 923 (1935); Bonbright and

This was the rule in reorganizations effected through federal equity receivership, the procedure commonly utilized by corporations before the enactment, in 1933 and 1934, of Sections 77 and 77B of the Bankruptcy Act. We submit that it is also the test of whether a plan is "fair and equitable" in reorganizations under the Bankruptcy Act.

In the consideration of plans of reorganization in equity receiverships prior to the enactment of Sections 77 and 77B, the doctrine of the *Boyd* case had frequently been expressed in the phrase "fair and equitable." The phrase had become a term of art in the law of equity reorganizations, employed to indicate that a plan met the requisite standards of fairness. *Jameson* v. *Guaranty Trust Co.*, 20 F. (2d) 808, 815 (C. C. A. 7th) ("equitable and fair"), certiorari denied, 275 U. S. 569; *Walsh Tie & Timber Co.* v. *St. Louis I. N. & S. R. Co.*, 280 Fed. 38, 44 (C. C. A. 8th), certiorari denied, 260 U. S. 743 (1922) ("fairly and equitably treated").[22]

Bergerman, *Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization*, 28 Col. L. Rev. 127 (1928); Friendly, *Some Comments on the Corporate Reorganization Act*, 48 Harv. L. Rev. 39 (1934); Note, 35 Col. L. Rev. 391, 549 (1935); Douglas and Frank, *Landlords' Claims in Reorganizations* (1933) 42 Yale L. Jour. 1003, 1009 *et seq.*; Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization* (1933) 19 Va. L. Rev. 541.

[22] Additional citations are collected in Spaeth and Winks, *op. cit. supra* at 779, n. 44. Similarly, this Court employed the phrase "fair and binding" as the standard to which a

The phrase "fair and equitable" was incorporated into Sections 77 and 77B and made a condition of confirmation of any reorganization plan under these sections.[29] Under a familiar canon of construction, the incorporation in a statute of a phrase which has acquired a fixed meaning through judicial interpretation demands that the phrase be read as understood by the courts.[30] And this Court has recognized that terms used in Section 77B are to be given the meaning they have acquired in the prior equity reorganization practice.[31]

Other provisions of Sections 77 and 77B corroborate the Congressional intention to incorporate the rule of absolute priority as an integral element in their operation. While these statutes generally require the assent of two-thirds of each class of creditors and a majority of each class of stock, as a condition to confirmation of any plan, all participation by stockholders may be eliminated and

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plan must conform. *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445, 452.

[29] Sec. 77 (e) (1), 11 U. S. C. 205 (e) (1); Sec. 77B (f) (1), 11 U. S. C. 207 (f) (1). The words "fair and" were added to Section 77 by amendment in 1935 (Aug. 27, 1935, c. 774, 49 Stat. 911, 918). The same test is retained in chapter X of the Bankruptcy Act, Secs. 174, 221 (2); 11 U. S. C. 574, 621 (2).

[30] *Standard Oil Co.* v. *United States*, 221 U. S. 1, 59; *Kepner* v. *United States*, 195 U. S. 100, 124.

[31] *Duparquet Huot & Moneuse Co.* v. *Evans*, 297 U. S. 216. And in *In re Central Funding Corporation*, 75 F. (2d) 256, 259 (C. C. A. 2d), a "reorganization" under Sec. 77B was defined by reference to prior equity definitions.

their assent is unnecessary if the debtor is shown to be insolvent[32]. Similarly, junior creditors need receive no participation under a reorganization plan, and their assent is unnecessary if no value exists for their interests.[33] The validity of such elimination has been recognized by this Court in its recent decision in *In re 620 Church Street Building Corporation,* 299 U. S. 24. In sustaining a plan which excluded junior-lien creditors, as well as stockholders, this Court said (at p. 27):

> * * * Petitioners insist that their consent to the plan of reorganization was necessary or that their claims should have been accorded "adequate protection." But the adequate protection to which the statute refers is "for the realization of the value of the interests, claims, or liens" affected. Here the controlling finding is not only that there was no equity in the property above the first mortgage but that petitioners' claims were appraised by the court at having "no value." There was no value to be protected. * * *

The principle of the *Boyd* case is thus embedded in the law of reorganizations under sections 77 and

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[32] Sec. 77 (e), 11 U. S. C. 205 (e); Sec. 77B (b) (4), (e) (1), 11 U. S. C. 207 (b) (4), (e) (1). The comparable provisions of chapter X are in Sections 179, 216 (8), 11 U. S. C. 579, 616 (8). The relevant portions of these provisions are set forth in Appendix B, *infra*, pp. 57–74.

[33] Sec. 77 (e), 11 U. S. C. 205 (e); Sec. 77B (b) (5), (e) (1), 11 U. S. C. 207 (b) (5), (e) (1). In chapter X: Sections 179, 216 (7), 11 U. S. C. 579, 616 (7).

77B by virtue both of the legislative intent evident in those sections and their judicial interpretation by this Court. Nevertheless, conflicting decisions among the lower federal courts, hereinafter discussed, have engendered a confusion which we submit should be resolved.

II

A PLAN WHICH IS UNFAIR AS A MATTER OF LAW CANNOT BE MADE VALID BY THE CONSENT OF THE PERCENTAGE OF A CLASS OF SECURITY HOLDERS REQUIRED FOR CONFIRMATION OF A PLAN

The petitioners in this case are dissenting bondholders, who under the plan are required as a class to surrender to stockholders 23% of the value of the enterprise, notwithstanding the fact that the debtor is insolvent and that the total value of the enterprise was found by the District Court to be less than one-third of the principal amount of the bonds outstanding. We have shown under Point I that the doctrine of the *Boyd* case clearly precludes such treatment of senior creditors in equity reorganizations, and in reorganizations under the Bankruptcy Act, in the absence of a contribution from such junior interests as are permitted participation. However, it has been argued that in reorganizations under Sections 77 and 77B the consent of two-thirds of the senior security holders to a plan which gives to their class less than fully compensatory treatment is binding upon the dissenting minority, though the plan provides partic-

ipation for junior classes for which there is no value.[34] Some of the lower federal courts have expressed this view in dicta [35] and decisions.[36]

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[34] This argument assumes such a plan is fair despite this Court's decision in *In re 620 Church St. Bldg. Corp.*, 299 U. S. 24, which, as we have said, recognized the application of the *Boyd* case principle to the reorganization statutes. Those who advance this argument seek to distinguish the *620 Church St. Bldg. Corp.* case, in our view unsuccessfully, on the ground that in that case the majority of creditors accepted a plan which *excluded*, rather than *included* valueless junior interests.

[35] *Downtown Investment Association* v. *Boston Metropolitan Buildings, Inc.*, 81 F. (2d) 314, 323–4 (C. C. A. 1st). The following statement in this opinion was quoted with approval by the District Court in the present case (R. 218):

"* * * A plan of reorganization when accepted is nothing more than an agreement between the debtor and its creditors and stockholders, or if the debtor has been declared insolvent, then between the several classes of creditors. When such contract or agreement has been accepted by the requisite majority of creditors and stockholders, the principle long recognized in composition cases steps in and under the supervision of the court imposes upon objecting minorities the will of the majority. This could not be accomplished under the acid tests applied to equity receiverships before the passage of 77B.

"We therefore hold that section 77B does not require that every plan approved as fair and equitable shall be of such character that it would withstand attack by non-assenting creditors asserting their strict legal rights unaffected by any principles of the Bankruptcy Act."

See also *In re Peyton Realty Co.*, 18 F. Supp. 822 (E. D. Pa.). *Cf. In re Burns Bros.*, 14 F. Supp. 910 (S. D. N. Y.).

[36] Despite a finding or assumption of insolvency, some courts have permitted stockholders to participate without requiring a new contribution. *In re A. C. Hotel Co.*, 93 F. (2d) 841 (C. C. A. 7th); *J. S. Farlee & Co.* v. *Springfield-*

We submit that the doctrine of the *Boyd* case operates to make such a plan no less unfair and inequitable in reorganizations under Sections 77 and 77B than it would have been in an equity receivership. The statute requires *both* that two-thirds of each class of creditors approve and that the plan be "fair and equitable." The former requirement is not a substitute for the basic requirement of fairness.[37]

This position has been adopted by the Circuit Court of Appeals for the Second Circuit in *In re Day & Meyer, Murray & Young*, 93 F. (2d) 657

South Main Realty Co., 86 F. (2d) 931 (C. C. A. 1st); *In re Celotex Co.*, 12 F. Supp. 1 (Del.); *In re United Railways & Electric Co.*, 11 F. Supp. 717 (Md.); *In re Syndicate Oil Corp.*, C. C. H. Bankr. Serv. (1936 ed.), par. 4155. See also *In re Middle West Untilities Co.*, C. C. H. Bankr. Serv. (1936 ed.), par. 3671. *Cf. In re Tharp Ice Cream Co.*, 25 F. Supp. 417 (E. D. Pa.).

Other courts have countenanced such participation apparently without making or demanding a finding of solvency. See *In re 333 North Michigan Ave. Bldg. Corp.*, 84 F. (2d) 936 (C. C. A. 7th), cert. denied, 299 U. S. 602; *In re Georgian Hotel Corp.*, 82 F. (2d) 917 (C. C. A. 7th), cert. denied, 298 U. S. 673; *In re Clark & Willow Streets Corp.*, 21 F. Supp. 43 (E. D. N. Y.).

[37] It is significant in the present case that the District Court, while seemingly regarding the *Boyd* doctrine as controlling (R. —), quoted with approval a case in support of the contrary view (R. 216–218), *supra* note 35. But while the District Court did not rest strongly on the latter ground, this Court is of course free to rest its opinion on any ground, whether or not advanced below. *Ridings* v. *Johnson*, 128 U. S. 212, 218. For this reason we discuss the validity of both views above-mentioned.

(C. C. A. 2d), where the court, facing the precise issue, stated (at 658-659):

> Such a plan does not preserve priorities. See *Northern Pacific Ry. Co.* v. *Boyd*. * * * It is the duty of the court to scrutinize the plans of reorganization proposed for insolvent companies to make certain that the assets belonging to creditors are not by indirection diverted to stockholders. * * * The fact that a large majority of the bondholders approved the plan is of no avail to sustain it.

The same view had been taken earlier by that court in *In re Barclay Park Corp.*, 90 F. (2d) 595 (C. C. A. 2d). In that case, dissenting bondholders protested against participation by stockholders for whom there was no equity. Despite the consent of more than three-fourths of the bondholders, the court reversed the order confirming the plan, saying (at pp. 597, 598):

> * * * we see no justification for canceling large amounts of interest on the claims of either the secured or the general creditors and giving common stock to persons who had no interest left in the enterprise. It was to prefer the stockholders at the expense of the creditors. * * * To justify a retention of a stock interest by the present shareholders it should appear that they have furnished an additional consideration or have an equity in the estate of the debtor after the rights of the creditors are fully provided for in some way.

The proposition was forcefully restated by the Circuit Court of Appeals for the Third Circuit in *In re Philadelphia & Reading Coal & Iron Co., Appeal of Schrager*, 105 F. (2d) 357:

> * * * A plan of reorganization of an insolvent debtor may not over the objection of a single creditor be approved as fair and equitable if it diverts to the stockholders any of the assets which by reason of the insolvency of the debtor belong solely to the creditors. *In re 620 Church Street Corporation*, 299 U. S. 24 * * *; *In re Barclay Park Corporation* * * *, 90 F. (2d) 595; *In re Day & Meyer, Murray and Young* * * * 93 F. (2d) 657; *Price* v. *Spokane Silver and Lead Co.* * * *, 97 F. (2d) 237; *Sophian* v. *Congress Realty Co.* * * *, 98 F. (2d) 499 * * *.[28]

As these courts have recognized, the consent of two-thirds of the class may bind a dissenting minority under Section 77B to a plan that is fair and equitable in law; but that consent is not the test of whether the plan is fair and equitable. If it is not fair and equitable by the criterion of the *Boyd* rule, as we submit is the case here, it cannot be approved by the court, despite the vote of the required majority. This Court, in disposing of a similar point in an equity case, characterized as "mistaken" the "* * * belief that it was the duty of the court to

[28] Also in accord are *Tellier* v. *Franks' Laundry Co.*, 101 F. (2d) 561 (C. C. A. 8th) and *In re Dutch Woodcraft Shops*, 14 F. Supp. 467 (W. D. Mich.).

aid in effectuating the Plan of Reorganization, since a very large majority of the debenture holders had assented to it.'"[39] And at the last term, this Court accepted the proposition as equally applicable to cases under Section 77B. *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307. In that case the Court reversed the order and decision of the lower courts which approved a plan of reorganization. The Court did so on the ground that the plan, and a claim compromise which was an integral part thereof, were unfair, despite the acceptance of the plan and the compromise by the requisite percentages of security holders.

The confusion of thought on this issue has been engendered by the use in the reorganization statutes of the device of compositions; that is, the device whereby a proposal becomes effective without the unanimous assent of creditors, upon agreement by a stated percentage of them. It is in this sense that the term has been used as descriptive of the procedure provided for by Sections 77 and 77B, generally in the consideration of the constitutionality of the device.[40] This has been emphasized by the

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[39] *First National Bank* v. *Flershem*, 290 U. S. 504, 525.

[40] In the same sense this Court has said: "a plan of reorganization * * * cannot be distinguished in principle from the composition with creditors * * *." *Continental Ill. Natl. Bank & Trust Co.* v. *Chicago R. I. & Pac. Ry. Co.*, 294 U. S. 648, 672. "The principle of composi-

statement of this Court in *Callaghan* v. *Reconstruction Finance Corporation*, 297 U. S. 464, at 470:

> Reorganizations now permitted under section 77B present certain resemblances to compositions under section 12 which have been commented upon as *supporting the constitutionality* of the reorganization provisions of section 77 or section 77B. * * * But section 77B contemplates a procedure and results not permissible under section 12. Reorganizations are nowhere referred to in the statute as compositions. [Italics supplied.]

The usefulness of the composition device lies in facilitating the mechanics of corporate reorganizations.[41] The innovation was merely procedural. But the test for judging the propriety of

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tion was first applied to the interest of secured creditors in their security, by § 74 * * *; by § 75 * * *; by § 77 * * *; by § 77B * * *." *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, 586n. 15. Similar expressions appear in *Adair* v. *Bank of America Natl. Trust & Sav. Assn.*, 303 U. S. 350; *United States* v. *Bekins*, 304 U. S. 27.

[41] Senate Report No. 1916, 75th Cong., 3d Sess. (on H. R. 8046, which revised and amended section 77B): "The most important contribution of section 77B to the development of the law was its adaptation of the *device* of bankruptcy compositions to the reorganization of large corporate enterprises. The constitutionality thereof is now well established, and the extent of its use has made it the basic procedure for the reorganization of corporations" (at 19). (Italics added.)

plans remains, as required by the statutes, the "fair and equitable" standard.[42]

No support for a contrary view can be found in the legislative background of Sections 77 and 77B. In enacting Section 77B, the Congress acted upon the assumption that that section substantially embodied the principles of Section 77, the earlier rail-

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[42] Proposals of the type sanctioned under the former composition sections of the Bankruptcy Act are no guide to what is "fair and equitable," for the approval of compositions under section 12 of the Bankruptcy Act was not conditioned on that test. Instead Section 12 (d) provided that "The judge shall confirm a composition if satisfied that (1) it is for the best interests of the creditors * * *." At least one court addressed itself as follows to this specific point in a Section 77B case: "A misconception of the fundamental purposes of the section here invoked appears in the record of proceedings before the special master. Early in these proceedings counsel for the debtor announced the view that the essential purpose of section 77B is to allow the debtor corporation to work out a plan so that creditors will receive approximately what they would obtain in bankruptcy proceedings and still allow the company to continue to function. This view cannot be sustained. * * * The preservation of business enterprises must not be at the expense of creditors, and the provisions of section 77B should not be taken advantage of to effect what, in fact, amounts to a composition under section 12 (11 U. S. C. A. § 30)." *In re Dutch Woodcraft Shops*, 14 F. Supp. 467, at 469 (W. D. Mich.).

Moreover, the general structure of the reorganization sections is inconsistent with the composition theory. Those sections require the submission of plans of reorganization submitted for acceptance by the security holders who participate therein. But the plan need not be submitted for acceptance by stockholders when the debtor is insolvent, or by junior creditors when their interests in the property are valueless. Sec. 77B (b) (4), (5), (e) (1), 11 U. S. C. 207 (b) (4), (5), (e) (1); Sec. 77 (e), 11 U. S. C. 205 (e); *In re 620*

road reorganization section."[43] The history of Section 77 discloses that Congress did not intend to curtail existing rights of creditors. A revision of the existing theory of priority rights would have gone to the very heart of the reorganization scheme. In view of the extended debate provoked by the far less serious procedural changes, an intention drastically to change and curtail these basic rights, with the result that constitutional bounds might possibly have been exceeded,[44] should at least have found unequivocal expression. No such expression is to be found.[45] To the contrary, both statutes require

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Church St. Bldg. Corp., 299 U. S. 24. Consequently, if valueless interests are offered participation pursuant to a composition theory, there is, in contrast with a fundamental purpose of the statutes, no mandatory machinery whereby they vote on the plan. This to be compared with the usual bankruptcy composition, where the offer may be made only by the debtor, and a composition to which the debtor is opposed cannot be consummated. Bankruptcy Act Sec. 12 (prior to 1938 amendment; 11 U. S. C. 30; chapter XI, 11 U. S. C. Sec. 701 *et seq.*

[43] "The scheme of this section is similar to that of section 77 of Chapter VIII entitled 'Reorganization of Railroads Engaged in Interstate Commerce,'" House Report No. 194, 73rd Cong., 1st Sess., on H. R. 5884, the bill which became Public, No. 296, 73rd Cong., and which contained Section 77B at p. 2. The Senate Committee adopted the House Report. Sen. Rep. No. 7482 on H. R. 5884, 73rd Cong., 2d Sess.

[44] Cf. Dodd, *Reorganization through Bankruptcy; a Remedy for what?* (1935) 48 Harv. L. Rev. 1100; *In re New York, N. H. & H. R. R. Co.*, 16 F. Supp. 504, 509. (Conn.).

[45] Representative Rayburn declared that it "will better protect bondholders and other preferred claimants in their rights than has been customary in receiverships." 76 Cong.

that the plan be "fair and equitable," a phrase whose content was definite and understood.

Finally, any theory which rests the "fairness" of a plan on the fact that it has won the approval of the requisite percentage of the security holders destroys the function which, plainly, the district court was meant to perform. If the consents of a majority, frequently illusory in nature,[46] are to

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Rec. 2918 (1933). That it was not intended to give the stockholders a more favorable position than they occupied under the *Boyd* case doctrine may be also inferred from the remark of Representative LaGuardia, a member of the Committee which reported the bill: "If the railroad is found to be insolvent * * * then stockholders are wiped out * * *." (*Id.* 2924.)

There are Congressional statements which analogize the reorganization sections to the old composition sections of the Act. Rep. Sumners, 76 Cong. Rec. 2908; Rep. Condon, *id.* 2913–14; Rep. Michener, *id.* 2928; Rep. McKeown, *id.* 2931 (1933). A memorandum by the Solicitor General contained comparable language (quoted in 76 Cong. Rec. 2771). It becomes apparent upon examination that these general references to principles of composition were not intended to sanction the impairmant of creditors' rights, but rather to describe and sanction the use in reorganizations of the *device* of composition, whereby the acceptance of a fair plan by a majority binds the minority to acceptance also. This did not, as we have said, trench on the criteria by which the fairness of the plan is to be judged.

[46] The Senate, in its report on chapter X of the amended Bankruptcy Act, revising Section 77B, stated: "*. * * Individual creditors fail to receive adequate information concerning either the debtor or the plans for its reorganization, and therefore lack the information upon which

control in every case, the determination by the court is at best a futile formality; there can never be any effective independent estimate of the fairness of a plan,[17] nor any effective standards of fairness. Nor would the scrutiny of the plan by the court serve any purpose after the vote, except to "rub-

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to base proposals of their own or upon which to determine whether to accept the proposals of others.

"The conditions imposed in section 77B upon the proposal of plans have rendered investor participation in the proposal of plans extremely difficult; as a result, creditors and stockholders, unable to take individual action in their own behalf and unable to attempt joint action because of difficulties in the way of obtaining other bondholders' and creditors' names and addresses, are in the main forced to depend upon self-constituted protective committees. *These committees, and others in similar roles, are able to present plans to the court under section 77B which have the ostensible, though not real, support of creditors and stockholders.* The courts are subjected thereby to an indefensible pressure to approve such plans, without giving to them the free and independent scrutiny which in theory the law requires. * * *" Senate Report No. 1916, 75th Cong., 3d Sess., at 22 (1938). (Italics supplied.)

[17] Yet under Section 77(d) and (e) the Interstate Commerce Commission must approve a plan *before* it is certified to the court, and *before* creditors and stockholders vote upon it. The Securities and Exchange Commission has a similar duty under the Public Utility Holding Company Act of 1935 for companies subject to that Act which are reorganized in the federal courts. Sec. 11(f); 15 U. S. C. 79K(f). And under chapter X of the amendatory Bankruptcy Act, revising Section 77B, the judge is required to consider and approve plans before creditors and stockholders are asked to vote upon it. Secs. 174–176, 11 U. S. C. 574–576.

ber stamp" the ostensible wishes of the creditors and stockholders."

We submit that the statute plainly contemplates that there shall be independent standards of fairness by which plans of reorganization may be judged and that there shall be an independent judicial appraisal of the fairness of the plan according to such standards. The conflict of opinion among the lower federal courts as to the correctness of this view emphasizes the need that the issue now be resolved by this Court.

III

THE ALLEGED "CONSIDERATION" TO BE FURNISHED BY THE STOCKHOLDERS DOES NOT SUPPORT THEIR PARTICIPATION UNDER THE PLAN

In the development of the *Boyd* doctrine, it has been recognized that there is one situation in which it may be proper to permit junior interests, having no value or equity in the debtor's assets, to participate in the reorganization. That is the case in which, in accordance with provisions in the plan, junior interests furnish a contribution for the privilege of retaining an interest in the reorganization. Unless this practice is limited, however, to cases where the contribution is either in money or in money's worth reasonably equivalent to the

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" But this Court said, in an equity reorganization case: "Every important determination by the court in receivership proceedings calls for an informed, independent judgment." *National Surety Co.* v. *Coriell*, 289 U. S. 426, 436.

participation afforded, the *Boyd* rule is violated by the diversion of values to the junior interests.

This Court has had occasion to sanction the practice, even as so limited, only in equity reorganizations, where it was at times necessary to raise funds in order to pay dissenting bondholders, or to provide the enterprise with new capital. It was believed that new investors could not be interested and that existing stockholders constituted the only available source of funds. It was assumed that they could be induced to contribute in the hope of salvaging a portion of their previous investment. This Court recognized the problem in both the *Boyd* and *Kansas City Terminal* cases. In the latter the Court said (271 U. S. 445, 455–6):

> Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. * * *
>
> * * * * * *
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> * * * No offer is fair which does not recognize the prior rights of creditors, as above pointed out; but circumstances may justify an offer of different amounts of the same grade of securities to both creditors and stockholders. Whenever assessments are demanded, they must be adjusted with the purpose of according to the creditor his full right of priority against the corporate assets, so far as possible in the existing circumstances.

In short, under the decisions of this Court valueless junior interests may be permitted to contribute and participate where: (a) new funds are essential; (b) the new funds cannot be obtained unless stockholders are permitted to contribute and retain an interest; and (c) the priorities of the creditors are protected to the fullest possible extent.

This rule of contribution has been deemed applicable to the reorganization statutes. For example, in *In re Dutch Woodcraft Shops*, 14 F. Supp. 467, 471 (W. D. Mich.), the court stated:

> Circumstances may exist where the success of an undertaking requires that new money be furnished and where the former stockholders are the only or most feasible source of new capital. In such instances, the Court may recognize as fair and equitable a plan which includes contributions of new money by stockholders, provided it satisfactorily appears that full recognition has been given to the value of creditors' claims against the property."

Representatives of valueless interests, however, have been alive to the possibility of circumventing the *Boyd* case doctrine and diverting to themselves values belonging to senior claimants by paying less.

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[49] Another case in accord is *In re Witherbee Court Corp.*, C. C. H. Bankr. Law Serv. (1936 ed.) par. 3727 (S. D. N. Y.).

than the fair equivalent for what they receive. In equity receiverships, the attempt was generally in terms of a demand for an excessive amount of securities for the cash paid. In reorganizations under the Bankruptcy Act, efforts to misapply the rule of contribution have taken a somewhat different form. The attempt now is to justify participation for these interests, not upon the basis of a cash contribution or even its equivalent, but upon the basis of "considerations" which are at best technical and at times wholly specious. The present case is but one such instance.

The District Court rested its determination that the stockholders' participation was authorized on findings which were substantially as follows:

(1) It will be an asset of value to the new company to retain the present Class A stockholders as stockholders because of their familiarity with the business, and because of their financial standing and influence in the community (R. 321);

(2) The principal valuable consideration passing between the bondholders and the stockholders is the virtual abrogation of the 1930 agreement deferring foreclosure until 1944 (R. 321–322); and

(3) The value to the bondholders of maintaining the Debtor as a going concern, and of avoiding litigation, exceeds the value of the stock being issued to the Class A shareholders (R. 323).

1. The first of these findings was apparently regarded as sufficient to support a conclusion of fairness and equity on the assumption that it was necessary to permit junior securities to retain stock in order to provide continuity of the existing management. Such an assumption rests in turn upon a confusion of management with stock ownership. Legally the two are separate and distinct.[50] And in practice there is ordinarily no necessary identity between granting stockholders participation and retaining or obtaining desirable management.

It is by no means axiomatic that the management of a corporation at the time of reorganization should be retained. On the contrary, the proceedings may bring to light facts showing that the retention of that management is not in the best interests of the corporation. As the circumstances in this case make plain, the problem of providing the reorganized company with a sound management should properly be considered as a question separate and distinct from that of the right of a class of security holders to participate in the plan. Situations may arise where a commitment to provide desired management can be procured only by the issuance of stock to the persons whose services are sought. This is a far cry, however, from the facts offered to justify stockholder participation in the instant case.

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[50] Berle and Means, *The Modern Corporation and Private Property* (1932), Chs. IV, V, VI.

Value is found here simply in the fact that the present stockholders are familiar with the business and have financial standing and influence in the community. Mention was also made in the District Court's opinion of business contacts (R. 227). But no management contract has been entered into here, and the stockholders have not committed themselves to use their influence, standing, or contacts in the interests of the corporation.

Certainly the continuation in office of members of the management who own no stock will not be insured by this method. Conversely, not all of the Class A stockholders are a part of the management (R. 84-5). Plainly, those who are not will have furnished no consideration if, in order to retain the few stockholders who constitute the management, stock is given to all.

This indiscriminate distribution of stock does not even insure retention of the services of those stockholders who are a part of the management. There is no finding that it would. To be sure, the members of the management have "expressed a willingness" to assume managerial responsibility, but they are not bound to do so (R. 227). There is nothing to prevent them from selling their stock, realizing their share of the 23% allotted to stockholders, and abandoning the enterprise. Such a possibility is by no means fanciful. The record indicates that the members of the management are unwilling to continue unless they can finance larger

building operations (R. 197). But a program of construction instead of repair requires rehabilitation of the plant, and it would cost $150,000 to put only one of the four building ways into first class condition (R. 71). The plan does not disclose the manner in which funds are to be raised.[51] If, as is possible, the funds are not raised, the managers may abandon the enterprise, and the stock allocation will have failed to insure continuity of present management.

If the rule requiring preservation of contract priorities is not to become a nullity, the allotment of stock as a consideration for managerial services should be limited to those who are to perform the services. And performance of the expected service should be removed from the realm of unfortified hope and made certain. The mere *possibility* that *some* of the stockholders may continue to furnish managerial services cannot, as a matter of law, be fair payment for the participation of the entire class of stockholders in the new corporation. Nor can such vague intangibles as business contacts, or the financial standing and influence of the stockholders in the community, without more, provide a

[51] If the funds are raised, it is not unlikely that the persons who contribute them will have something to say about the management. If they have confidence in the present management, they may insist that its continuation be insured by employment contracts, in which case the allotment of stock to the managers is unnecessary. On the other hand, they may install their own management, in which case allotment of stock to the present managers will have been futile.

basis for the issuance of stock to them. Securities should be issued only to the extent that they represent a fair payment for a definite undertaking, valuable to the reorganized enterprise.

We are sustained in this position by *In re Barclay Park Corp.*, 90 F. (2d) 595, 598 (C. C. A. 2d), which declared:

> It is argued that the stockholders represent the present management of the hotel and that the management is valuable and indeed necessary to the enterprise and that the manager-stockholders will "walk out" if the proposed plan does not go through and leave the hotel to its fate. But there is no binding agreement on their part to remain which might afford a justification for giving them a stock interest and, if their managerial skill is vital to the success of the hotel, any stock issued to insure the continuance of their relation ought to go to those stockholders who are of use to the enterprise and agree to act in its behalf, and not to all stockholders as such.

2. The second finding of the District Court relates to the alleged surrender by stockholders of a right, by reason of the terms of the 1930 agreement, to defer foreclosure of the mortgage securing the bonds until 1944.

There was, however, no such right once the petition for reorganization, voluntarily filed by the stockholders through their control of the debtor (R. 77, 79, 101), was approved. In instituting the

reorganization proceeding, the Debtor and the stockholders accepted all the consequences which might flow from the reorganization, including the confirmation of a plan which eliminated their interests. After approval of the petition, they were powerless to withdraw merely because the requirements of a fair plan precluded their participation. Voluntary reorganization proceedings have not infrequently ended with plans excluding stockholders.[32] This necessarily follows where it is found that they have no equity and have made no fresh contribution in money or in money's worth. No such contribution can be found in the surrender of a right already waived.

In any event no such right could exist once it was determined that the value of the enterprise was less than the creditors' claims. Under the absolute priority doctrine the assets thereafter belonged to the creditors. The stockholders had no interest in the estate upon the basis of which they could assert any rights adverse to the claims of the bondholders.

The District Court's contrary conclusion resulted from its erroneous assumption that if the Debtor's plan was not confirmed, the proceeding would have to be dismissed, restoring the stockholders' rights under the indenture (R. 227, 238). But dismissal was by no means the only alternative to approval of the plan. There was no showing

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[32] E. g., *In re Reading Hotel Corp.*, 89 F. (2d) 53 (C. C. A. 3d), certiorari denied, 302 U. S. 742.

that a fair, feasible, and proper plan, complying with the statute in all respects, and confining participation to the bondholders, could not be adopted. Consequently the Court could properly refuse to surrender jurisdiction. *Matter of Bush Terminal Co.*, 84 F. (2d) 984 (C. C. A. 2d), certiorari denied, 299 U. S. 596.

3. The District Court, in its third finding, assumed that the issuance of stock to the Class A stockholders was justified as a means of avoiding litigation with them. Their position, in essence, was that it was proper to buy them off though their interests were concededly worthless. There is no reason why courts should bow before such threats. Holders of clearly valueless interests should not be permitted to enforce their demands by threats of extended controversy. The court was required by the statute to find whether the plan was "fair and equitable." This means that it was to resist, not to reinforce, claims based upon nuisance value.

The third finding of the District Court also recites that the value to the bondholders of maintaining the Debtor as a going concern, and of avoiding litigation, exceeds the value of the stock allotted to the Class A stockholders. But since, as we have pointed out, these did not constitute a valid contribution, determination of their value is irrelevant.

The test of the adequacy of contributions to sustain participation of valueless interests in a fair plan is not one of technical consideration in the

contract sense. Whether stockholders for whom there is no equity may participate in the reorganized corporation must depend upon whether they pay a fair equivalent for what they are to receive. Without such a test, evasions of the absolute priority doctrine are likely to become the settled course of reorganization procedure.

CONCLUSION

For the reasons stated above, we submit that the plan of reorganization involved in these cases is not "fair and equitable," and that the decision of the court below approving confirmation of the plan should be reversed.

Respectfully submitted.

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OCTOBER, 1939.

APPENDIX A

Leading Decisions of this Court on the Absolute Priority Doctrine

The decisions of this Court on the absolute priority rule begin with *Railroad Co.* v. *Howard*, 7 Wall. 392. The principle on which that case rests was articulated in *Louisville Trust Co.* v. *Louisville, Albany & Chicago Ry. Co.*, 174 U. S. 674, the famous "Monon" case. Without reviewing the facts of the latter case at length, it is sufficient to say that they involved an attack by an unsecured creditor on a decree of foreclosure and sale of a railroad mortgage, on the ground that the mortgage had been foreclosed by agreement between mortgage bondholders and stockholders for the purpose of eliminating the rights of unsecured creditors. This Court said, by Mr. Justice Brewer (p. 683):

> We do not stop to inquire, because the question is not presented by this record, whether a court is justified in permitting a foreclosure and sale which leaves any interest in the mortgagor, to wit, the railroad company and its stockholders, and ought not always to require an extinction of all the mortgagor's interest and a full transfer to the mortgagee, representing the bondholders. Assuming that foreclosure proceedings may be carried on to some extent at least in the interests and for the benefit of both mort-

> gagee and mortgagor, (that is, bondholder and stockholder (we observe that no such proceedings can be rightfully carried to consummation which recognize and preserve any interest in the stockholders without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation. In other words, if the bondholder wishes to foreclose and exclude inferior lienholders or general unsecured creditors and stockholders he may do so, but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and preserve the prior rights of general creditors thereof. This is based upon the familiar rule that the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors. And any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation.

The famous case of *Northern Pacific Ry. Co.* v. *Boyd,* 228 U. S. 482 involved the same issue. The Court there said, by Mr. Justice Lamar (pp. 504, 507–8):

> Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred before the creditor was invalid. * * * The invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, for in cases like this, the question must be decided according to a fixed principle, not leaving the rights of the creditors to depend upon the

balancing of evidence as to whether, on the day of sale the property was insufficient to pay prior encumbrances. * * * If the value of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value whether it was present or prospective, for dividends or only for purposes of control. In either event it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever.

This conclusion does not, as claimed, require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock.

In *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445 the Court applied these principles to answer three questions certified by the Circuit Court of Appeals for the Eighth Circuit, as follows (pp. 452–453):

I. Is a plan of reorganization of a railway company sufficient as to unsecured creditors and binding upon them which does not give precedence to the entire claim of the creditor over any part or interest of a stockholder in the old company?

II. Is such a plan fair and binding upon such creditors even though they be offered securities of the same grade as the stockholders, the difference being only in the greater amount offered the creditors, provided the court shall be of the opinion that the offer tenders to such creditors all that

could reasonably be expected under all of the existing circumstances?

III. Is such offer as to such creditors fair and binding if it consists only of the same grade of securities as offered the stockholders, the difference being that the right of the stockholders to participate is conditioned upon the payment of an assessment or the payment of a relatively greater assessment than that asked of such creditors, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?

The Court answered, by Mr. Justice McReynolds (pp. 454–455–456):

* * * when necessary, they [unsecured creditors] may be protected through other arrangements [than payment in cash, income bonds, or preferred stock] which distinctly recognize their equitable right to be preferred to stockholders against the full value of all property belonging to the debtor corporation, and afford each of them fair opportunity, measured by the existing circumstances, to avail himself of this right.

Unsecured creditors of insolvent corporations are entitled to the benefit of the values which remain after lien holders are satisfied, whether this is present or prospective, for dividends or only for purposes of control. But reasonable adjustments should be encouraged. Practically, it is impossible to sell the property of a great railroad for cash; and, generally, the interest of all parties, including the public, are best served by cooperation between bondholders and stockholders. If creditors decline a fair offer based upon the principles above stated,

they are left to protect themselves. After such refusal they cannot attack the reorganization in a court of equity. *Northern Pacific Railway Co.* v. *Boyd*, p. 508.

Question I, if interpreted strictly and according to the ordinary meaning of the words employed, must be answered in the negative. We assume that to "give precedence" implies recognition of superior importance. As above stated, to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation. But it does not follow that in every reorganization the securities offered to general creditors must be superior in rank or grade to any which stockholders may obtain. It is not impossible to accord to the creditor his superior rights in other ways. Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. In such or similar cases the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights.

Question II is answered in the affirmative with the qualifications which follow. The primary right of unsecured creditors to the assets of an insolvent corporation remaining after lien holders are satisfied, must be adequately protected; and to each one of them there must be given such opportunity as the circumstances permit to secure the full enjoyment of this preference.

Question III is also answered in the affirmative, subject to the following qualification. No offer is fair which does not recognize the prior rights of creditors, as above

pointed out; but circumstances may justify an offer of different amounts of the same grade of securities to both creditors and stockholders. Whenever assessments are demanded, they must be adjusted with the purpose of according to the creditor his full right of priority against the corporate assets, so far as possible in the existing circumstances.

APPENDIX B

STATUTORY PROVISIONS

SECTION 77B OF THE BANKRUPTCY ACT OF 1898

(48 Stat. 911 (1934); am'd, 49 Stat. 664 (1935); am'd, 49 Stat. 965 (1935); am'd, 50 Stat. 622 (1937); 11 U. S. C. § 207)

(b) (11 U. S. C. § 207 (b)) A plan of reorganization within the meaning of this section * * *

(4) shall provide in respect of each class of stockholders, of which less than a majority shall accept such plan (unless the judge shall determine either that the debtor is insolvent, or that the interest of such class of stockholders will not be affected adversely by the plan), adequate protection for the realization by them of the value of their equity, if any, in the property of the debtor dealt with by the plan, either, as provided in the plan, (a) by a sale of the property at not less than a fair upset price, or (b) by appraisal and payment in cash of the value either of their stock, or at the objecting stockholders' election, of the securities allotted to such stockholders under the plan, if any shall be so allotted, or (c) by such methods as will do substantial justice to such stockholders under and consistent with the circumstances of the particular case;

(5) shall provide in respect of each class of creditors of which less than two-thirds in amount shall

accept such plan (unless the claims of such class of creditors will not be affected by the plan, or the plan makes provision for the payment of their claims in cash in full), provide adequate protection for the realization by them of the value of their interests, claims, or liens, if the property affected by such interests, claims, or liens is dealt with by the plan, either as provided in the plan (a) by the transfer or sale of such property subject to such interests, claims, or liens, or by the retention of such property by the debtor subject to such interests, claims, or liens, or (b) by a sale free of such interests, claims, or liens at not less than a fair upset price and the transfer of such interests, claims, or liens to the proceeds of such sale; or (c) by appraisal and payment either in cash of the value either of such interests, claims, or liens, or, at the objecting creditors' election, of the securities allotted to such interests, claims, or liens under the plan, if any shall be so allotted; or (d) by such method as will in the opinion of the judge, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

* * * * * *

(d) (11 U. S. C. §207 (d)) A plan of reorganization which has been approved by creditors of the debtor, whose claims would be affected by the plan, being not less than 25 per centum in amount of any class of creditors, and not less than 10 per centum in amount of all the claims against the debtor, or, if the debtor is not found by the judge to be insolvent, but is found unable to meet its debts as they mature, by stockholders whose interests would

be affected by the plan, provided said amount is not less than 10 per centum of any class of stock outstanding and not less than 5 per centum of the total number of shares of all classes of stock outstanding, may be proposed by any creditor or by any stockholder, or without such approval by the debtor, at a hearing duly noticed for its consideration or for the consideration of any other plan of reorganization similarly proposed.

(e) (1) (11 U. S. C. § 207 (e) (1)) A plan of reorganization shall not be confirmed until it has been accepted in writing, whether before or after the filing of the petition or answer under this section, and such acceptance shall have been filed in the proceeding by or on behalf of creditors holding two-thirds in amount of the claims of each class whose claims have been allowed and would be affected by the plan and by or on behalf of stockholders of the debtor holding a majority of the stock of each class: *Provided, however,* That such acceptance shall not be requisite to the confirmation of the plan by any creditor or class of creditors (a) whose claims are not affected by the plan, or (b) if the plan makes provision for the payment of their claims in cash in full, or (c) if provision is made in the plan for the protection of the interests, claims, or liens of such creditor or class of creditors in the manner provided in subdivision (b), clause (5), of this section: *And provided further,* That such acceptance shall not be requisite to the confirmation of the plan by any stockholder or class of stockholders (1) if the judge shall have determined either that the debtor is insolvent, or that the interests of such stockholder or stock-

holders will not be affected by the plan, or (2) if provision is made in the plan for the protection of the interests of such stockholder or class of stockholders in the manner provided in subdivision (b), clause (4), of this section.

* * * * *

(f) (11 U. S. C. § 207 (f)) After hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that (1) it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible; (2) it complies with the provisions of subdivision (b) of this section; (3) it has been accepted as required by the provisions of subdivision (e), clause (1) of this section; * * *

CHAPTER X OF THE BANKRUPTCY ACT OF 1898

(52 Stat. 883 (1938); 11 U. S. C. § 501 *et seq.*)

SEC. 169 (11 U. S. C. § 569). Where a trustee has been appointed the judge shall fix a time within which the trustee shall prepare and file a plan, or a report of his reasons why a plan cannot be effected, and shall fix a subsequent time for a hearing on such plan or report and for the consideration of any objections which may be made or of such amendments or plans as may be proposed by the debtor or by any creditor or stockholder.

SEC. 170 (11 U. S. C. § 570). Where a debtor is continued in possession, a plan or plans may be filed, within a time fixed by the judge—

(1) by the debtor;

(2) by any creditor or indenture trustee;

(3) by any stockholder, if the debtor is not found to be insolvent;

(4) by the examiner, if so directed by the judge. The judge shall fix a subsequent time for a hearing on such plans and for the consideration of any objections or amendments thereto.

* * * * * *

SEC. 172 (11 U. S. C. § 572). After the hearing, as provided in section 169 or section 170 of this Act, and before the approval of any plan, as provided in section 174 of this Act, the judge may, if the scheduled indebtedness of the debtor does not exceed $3,000,000, and shall, if such indebtedness exceeds $3,000,000, submit to the Securities and Exchange Commission for examination and report the plan or plans which the judge regards as worthy of consideration. Such report shall be advisory only.

SEC. 173 (11 U. S. C. § 573). The judge shall not enter an order approving a plan submitted to the Securities and Exchange Commission until after the Securities and Exchange Commission has filed its report thereon or has notified the judge that it will not file a report, or until the expiration of such reasonable time for the filing of such report as the judge has fixed, whichever first occurs.

SEC. 174 (11 U. S. C. § 574). After the hearing, as provided in section 169 or section 170 of this Act, and, if a plan has been submitted to the Securities and Exchange Commission, as provided in section 172 of this Act, then after the filing of the report or notice that it will not be filed, or after the expiration of the time for its filing, whichever first occurs, the judge shall enter an order approving the plan or plans which in his opinion comply

with the provisions of section 216 of this Act, and which are fair and equitable, and feasible, and shall fix a time within which the creditors and stockholders affected thereby may accept the same.

SEC. 175 (11 U. S. C. § 575). Upon the approval of a plan by the judge, the trustee or the debtor in possession shall transmit, by mail or otherwise, to all creditors and stockholders who are affected by any such plan—

(1) the plan or plans so approved, together with a summary thereof approved by the judge;

(2) the opinion of the judge, if any, approving the plan, or plans, or a summary thereof approved by the judge;

(3) the report, if any, filed in the proceeding by the Securities and Exchange Commission, as provided in section 172 of this Act, or a summary thereof prepared by the Securities and Exchange Commission; and

(4) such other matters as the judge may deem necessary or desirable for the information of creditors and stockholders.

SEC. 176 (11 U. S. C. § 576). No person shall, without the consent of the court, solicit any acceptance, conditional or unconditional, of any plan, or any authority, conditional or unconditional, to accept any plan, whether by proxy, deposit, power of attorney or otherwise, until after the entry of an order approving such plan and the transmittal thereof to the creditors and stockholders, as provided in section 175 of this Act; and any such authority or acceptance given, procured, or received by reason of a solicitation prior to such approval

and transmittal shall be invalid, unless such consent of the court has been so obtained.

* * * * *

SEC. 179 (11 U. S. C. § 579). After a plan has been accepted in writing, filed in court, by or on behalf of creditors holding two-thirds in amount of the claims filed and allowed of each class, and, if the debtor has not been found to be insolvent, by or on behalf of stockholders holding the majority of stock, of which proofs have been filed and allowed, of each class, exclusive of creditors or stockholders or of any class of them who are not affected by the plan or whose claims or stock are disqualified pursuant to section 203 of this Act, or for whom payment or protection has been provided as prescribed in paragraphs (7) and (8) of section 216 of this Act, the judge shall fix a hearing, upon notice to the debtor, creditors, stockholders, indenture trustees, the Secretary of the Treasury, the Securities and Exchange Commission, and such other persons as the judge may designate, for the consideration of the confirmation of the plan and of such objections as may be made to the confirmation.

* * * * *

SEC. 208 (11 U. S. C. § 608). The Securities and Exchange Commission shall, if requested by the judge, and may, upon its own motion if approved by the judge, file a notice of its appearance in a proceeding under this chapter. Upon the filing of such notice, the Commission shall be deemed to be a party in interest, with the right to be heard on all matters arising in such proceeding, and shall be deemed to have intervened in respect of all matters

in such proceeding with the same force and effect as if a petition for that purpose had been allowed by the judge; but the Commission may not appeal or file any petition for appeal in any such proceeding.

* * * * * *

Sec. 216 (11 U. S. C. § 616). A plan of reorganization under this chapter—

* * * * * *

(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or (b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

(8) shall provide for any class of stockholders which is affected by the plan and does not accept the plan by the majority of the stock required under this chapter, adequate protection for the realization by them of the value of their equity, if any, in the property of the debtor dealt with by the plan, either as provided in the plan or in the order confirming the plan, (a) by the sale of such property at not

less than a fair upset price; or (b) by appraisal and payment in cash of the value of their stock; or (c) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection: *Provided, however,* That such protection shall not be required if the judge shall determine that the debtor is insolvent;

* * * * * *

SEC. 221 (11 U. S. C. § 621). The judge shall confirm a plan if satisfied that—

* * * * * *

(2) the plan is fair and equitable, and feasible;

* * * * * *

SEC. 276 (U. S. C. § 676) * * *

(c) the provisions of section 77A and 77B of chapter VIII, as amended, of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that—

(1) if the petition in such proceedings was approved within three months prior to the effective date of this amendatory Act, the provisions of this chapter shall apply in their entirety to such proceedings; and

(2) if the petition in such proceedings was approved more than three months before the effective date of this amendatory Act, the provisions of this chapter shall apply to such proceedings to the extent that the judge shall deem their application practicable; * * *

(47 Stat. 1474 (1933); am'd, 48 Stat. 924 (1934); am'd, 49 Stat. 911 (1935); am'd, 49 Stat. 1969 (1936); 11 U. S. C. § 205)

d. (11 U. S. C. § 205 (d)) TIME FOR FILING PLAN OF REORGANIZATION; HEARINGS BY COMMISSION; CERTIFICATION OF APPROVAL TO COURT.—The debtor, after a petition is filed as provided in subsection a of this section, shall file a plan of reorganization within six months of the entry of the order by the judge approving the petition as properly filed, or if heretofore approved, then within six months of August 27, 1935, and not thereafter unless such time is extended by the judge from time to time for cause shown, no single extension at any one time to be for more than six months. Such plan shall also be filed with the Commission[1] at the same time. Such plans may likewise be filed at any time before, or with the consent of the Commission during, the hearings hereinafter provided for, by the trustee or trustees, or by or on behalf of the creditors being not less than 10 per centum in amount of any class of creditors, or by or on behalf of any class of stockholders being not less than 10 per centum in amount of any such class, or with the consent of the Commission by any party in interest. After the filing of such a plan, the Commission, unless such plan shall be considered by it to be prima facie impracticable, shall, after due notice to all stockholders and creditors given in such manner as it shall determine,

[1] Interstate Commerce Commission. Sec. 77 (a), 11 U. S. C. 205 (a).

hold public hearings, at which opportunity shall be given to any interested party to be heard, and following which the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections b and e of this section, and will be compatible with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions.

The Commission may thereafter, upon petition for good cause shown filed within sixty days of the date of its order, and upon further hearings if the Commission shall deem necessary, in a supplemental report and order modify any plan which it has approved, stating the reasons for such modification. The Commission, if it approves a plan, shall thereupon certify the plan to the court together with a transcript of the proceedings before it and a copy of the report and order approving the plan. No plan shall be approved or confirmed by the judge in any proceeding under this section unless the plan shall have been approved by the Commission and certified to the court.

e. (11 U. S. C. § 205 (e)) COURT HEARING AFTER APPROVAL BY COMMISSION; ACCEPTANCE OF PLAN BY CREDITORS AND STOCKHOLDERS; CONFIRMATION OF PLAN BY COURT; VALUATION OF PROPERTY.—Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and

such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection b of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection c, paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such

payment, and the judge is hereby given power to approve the same.

If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. If the proceedings are referred back to the Commission, it shall proceed to a reconsideration of the proceedings under the provisions of subsection d of this section. If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection c of this section, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: *Provided,* That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value, or

that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, or (b) that the interests of such class of stockholders will not be adversely and materially affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance: *Provided further*, That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. For the purpose of this section the acceptance or rejection by any creditor or stockholder shall be in writing, executed by him or by his duly authorized attorney, committee, or representative. If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation) the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests or claims thereof shall be deemed to be affected by the plan, and the President of the United States, or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation. The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission.

Upon receipt of such certification, the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: *Provided,* That if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection e: * * *

PUBLIC UTILITY ACT OF 1935

(49 Stat. 803 (1935); 15 U. S. C. § 79)

SEC. 11 (15 U. S. C. § 79k). * * * (f) In any proceeding in a court of the United States, whether under this section or otherwise, in which a

receiver or trustee is appointed for any registered holding company, or any subsidiary company thereof, the court may constitute and appoint the Commission [2] as sole trustee or receiver, subject to the directions and orders of the court, whether or not a trustee or receiver shall theretofore have been appointed, and in any such proceeding the court shall not appoint any person other than the Commission as trustee or receiver without notifying the Commission and giving it an opportunity to be heard before making any such appointment. In no proceeding under this section or otherwise shall the Commission be appointed as trustee or receiver without its express consent. In any such proceeding a reorganization plan for a registered holding company or any subsidiary company thereof shall not become effective unless such plan shall have been approved by the Commission after opportunity for hearing prior to its submission to the court. Notwithstanding any other provision of law, any such reorganization plan may be proposed in the first instance by the Commission or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization. The Commission may, by such rules and

[2] Securities and Exchange Commission. Sec. 2 (a) (6), 15 U. S. C. 79b (a) (6).

regulations or order as it may deem necessary or appropriate in the public interest or for the protection of investors or consumers, require that any or all fees, expenses, and remuneration, to whomsoever paid, in connection with any reorganization, dissolution, liquidation, bankruptcy, or receivership of a registered holding company or subsidiary company thereof, in any such proceeding, shall be subject to approval by the Commission.

(g) It shall be unlawful for any person to solicit or permit the use of his or its name to solicit, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, any proxy, consent, authorization, power of attorney, deposit, or dissent in respect of any reorganization plan of a registered holding company or any subsidiary company thereof under this section, or otherwise, or in respect of any plan under this section for the divestment of control, securities, or other assets, or for the dissolution of any registered holding company or any subsidiary company thereof, unless—

(1) the plan has been proposed by the Commission, or the plan and such information regarding it and its sponsors as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers has been submitted to the Commission by a person having a bona fide interest (as defined by the rules and regulations of the Commission) in such reorganization;

(2) each such solicitation is accompanied or preceded by a copy of a report on the plan which shall be made by the Commission after an opportunity for a hearing on the plan and

other plans submitted to it, or by an abstract of such report made or approved by the Commission; and

(3) each such solicitation is made not in contravention of such rules and regulations or orders as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers.

Nothing in this subsection or the rules and regulations thereunder shall prevent any person from appearing before the Commission or any court through an attorney or proxy.

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